123 FERC ¶ 61,306
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

New York Independent System Operator, Inc.	Docket No. ER04-230-034
New York Independent System Operator, Inc.	ER04-230-035

ORDER ON REQUEST FOR CLARIFICATION
AND TARIFF FILING

(Issued June 25, 2008)

1. In this order, the Commission rules on a request for clarification and a tariff filing by the New York Independent System Operator, Inc. (NYISO) on June 9, 2008, regarding credit requirements for Demand Side Resources that offer Operating Reserves and Regulation Service into the NYISO-administered markets. The Commission grants clarification of its May 23, 2008 Order in this docket,[1] which rejected without prejudice NYISO's proposed credit requirements for Demand Side resources, that the Commission did not intend that Demand Side Resources be permitted to participate in the ancillary services markets until credit requirements for Demand Side Resources have been approved. The Commission further accepts NYISO's June 9, 2008 re-filing of its previously-filed but rejected credit requirements for Demand Side Resources, effective May 24, 2008.

I. Background

2. On March 24, 2008, NYISO submitted proposed revisions to its Market Administration and Control Area Services Tariff (Services Tariff) and Open Access Transmission Tariff (OATT) to enable certain Demand Side Resources to offer Operating Reserves and Regulation Service into the NYISO-administered markets. In that filing, NYISO proposed credit requirements for Demand Side Resources that were modeled after the credit requirements imposed on virtual bidders, because of the similarities between the two types of entities in terms of their exposure to balancing costs.

[1] *New York Independent System Operator, Inc.*, 123 FERC ¶ 61,134 (2008) (May 23, 2008 Order).

3. On May 23, 2008, the Commission issued an order conditionally accepting NYISO's March 24, 2008 filing in part, but rejected NYISO's proposed credit requirements without prejudice:

> NYISO is proposing credit requirements for Demand Side Resource Suppliers modeled after the credit requirements imposed on virtual bidders because of their similarities in exposure to balancing costs. NYISO states that generators that routinely show a net payable position in NYISO settlements avoid these credit obligations because NYISO can offset generators' balancing obligation in the ancillary services market against their net payable position. . . .
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> We recognize that credit requirements are important for a well-working market and it may be that NYISO's proposed credit requirements are reasonable. However, NYISO has not yet provided sufficient information to justify its proposal. Therefore, we will reject NYISO's proposal without prejudice to NYISO re-filing its proposal in 60 days with adequate support.[2]

4. On June 9, 2008, NYISO made the two separate filings that this order addresses.

5. First, NYISO filed a Request for Clarification and Expedited Action with regard to the Commission's finding regarding credit requirements for Demand Side Resources. NYISO asked the Commission to clarify that it did not intend that Demand Side Resources be allowed to participate in NYISO's ancillary services markets until credit rules were in place. NYISO also noted that it was separately filing to re-submit its proposed credit requirements with additional support, and asked for expedited treatment of that filing, so that the credit requirements would be in place before prospective Demand Side Resources complete the NYISO customer registration process and become eligible to participate in the ancillary services markets.

6. Second, NYISO also re-filed the same tariff credit requirements, but with additional support for the credit requirements, as previously included in NYISO's March 24, 2008 filing.[3]

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[2] May 23, 2008 Order, 123 FERC ¶ 61,134 at P 50-51.

[3] Although NYISO describes its June 9, 2008 tariff filing as a compliance filing, the Commission did not order it to be made and, accordingly, it will be treated as a new FPA section 205 filing.

7. Notice of NYISO's June 9, 2008 filing was published in the *Federal Register*, with answers, protests, and motions to intervene due by June 19, 2008.[4] Multiple Intervenors[5] filed comments supporting NYISO's compliance filing.

II. Discussion

A. Request for Clarification

8. The Commission clarifies that it did not intend that Demand Side Resources should be able to make offers into NYISO's Operating Reserves and Regulation Service markets until credit requirements for Demand Side Resources have been put into place by NYISO. The Commission has previously stressed the importance of balancing the benefits of allowing virtual bidders to enter a Regional Transmission Organization (RTO)'s markets with the necessity of protecting customers from the risks of a potential default by such market participant.[6] A similar possibility for harm to customers exists if a demand resource defaults on its obligation without appropriate credit protections in place. However, in light of our concurrent action below accepting NYISO’s proposed Demand Side Resource credit requirements effective May 24, 2008, NYISO’s request for clarification largely should be moot.[7]

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[4] 73 Fed. Reg. 34,925 (2008).

[5] Multiple Intervenors describe themselves as "an unincorporated association of over 50 large industrial, commercial and institutional energy consumers with manufacturing and other facilities located throughout New York State." Comments of Multiple Intervenors at 1 n. 2.

[6] *See PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,309 at P 20 (2003) ("[V]irtual bidding can provide market benefits such as increased market liquidity and price convergence between the day ahead and real time markets, [but w]e also agree that PJM's existing credit requirements, which are based primarily on physical trades, fail to adequately protect PJM's market participants from the default risks presented by entities that primarily engage in virtual bidding. Thus, it is appropriate that PJM's existing collateralization requirements be increased from their existing levels") (footnotes omitted). *See also Morgan Stanley Capital Group, Inc*. v. *New York Independent System Operator, Inc*., 98 FERC ¶ 61,077 (2002) (Commission affirms that NYISO's policy of having credit requirements for virtual bidders to be just and reasonable).

[7] NYISO states that "it will be at least several weeks before any potential supplier completes the registration package." Request for Clarification at 2.

B. Proposed Credit Requirements

1. NYISO's filing and comments

9. In its June 9, 2008 tariff filing, NYISO provides the following support for its proposed credit requirements for Demand Side Resources. It states that it designed the proposed credit requirements to ensure that it could obtain sufficient collateral from Demand Side Resources offering ancillary services to cover any potential net negative financial positions that could arise from their participation in the markets. NYISO states that "[u]npaid negative financial positions can create a bad debt loss that would be spread market-wide,"[8] and states that the proposed credit requirements reasonably reflect the extent of this potential bad debt loss by estimating the actual market settlements a Demand Side Resource may experience based on its scheduled ancillary services market activity and the time of year. NYISO explains that the credit requirements would be set at levels based on empirical information, i.e., data on activity in the relevant ancillary services market for the same two-month period during the prior year.

10. NYISO describes the possibility that a demand resource might default on its obligations, and thus cause harm to other market participants, as follows. Both generation and demand resources are required to balance their positions (positive and negative) in NYISO's markets. It explains that a resource is required to balance its obligations when either (i) its ancillary services schedule is converted to energy, or (ii) it fails to provide the ancillary services that it was scheduled to provide, due to a technical problem or otherwise. NYISO states that a Demand Side Resource can acquire a net negative financial position if it accumulates a balancing obligation in excess of its revenue position, and such balancing obligations have the potential quickly to create multiple net negative financial consequences if they fail to provide their scheduled ancillary service when called upon on multiple occasions, before NYISO can suspend the resource's market activity.

11. NYISO asserts that, in developing its proposed credit requirements, it considered a worst-case scenario in which a Demand Side Resource completely fails to perform when called upon, i.e., if the real-time market clearing price, on which the resource's balancing obligation would be based, exceeded the day-ahead market clearing price the resource was paid; and the resource continued to bid, continued to be paid and continued not to perform until NYISO could suspend its market activity. NYISO states that as a general matter, the NYISO's credit requirements for all markets and all types of suppliers are based on a worst-case analysis in order to maximize the protection against market-wide bad debt loss.

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[8] NYISO transmittal letter at 4.

12. Thus, NYISO states, its proposed tariff provisions establish an individualized credit requirement based upon the product of a supplier's maximum daily exposure to net-negative balancing obligations, and the number of days this exposure could continue until NYISO had an opportunity to suspend uncollateralized market activity. It asserts that the design of the NYISO's market bidding and settlement processes leaves it with a potential exposure to three days of net-negative financial settlements before it would have an opportunity to suspend uncollateralized market activity.

13. NYISO states that a supplier's maximum daily exposure to net-negative balancing obligations is a product of the maximum daily operating capacity (in MW) for which the Demand Side Resource may be scheduled and the potential cost of balancing its market position. The potential cost of balancing a supplier's market position is based upon the product of the intervals in which the supplier may incur a daily balancing obligation and the price differential between the day-ahead clearing price it was paid for its service and the real-time clearing price upon which its balancing obligation would settle.[9] Stated simply, a demand resource's collateral requirement would be three days' worth of estimated capacity reduction, times the difference in day-ahead and real-time prices.

14. To ensure that these estimates of capacity reduction provide reasonable results, NYISO proposes to recalculate the credit requirement every two months using data on the number of intervals in which a Demand Side Resource may face balancing obligations and on the day-ahead and real-time prices from the same two-month period in the previous year. To avoid overly conservative estimates for the potential maximum number of activations to which a Demand Side Resource selling Operating Reserves may be exposed, NYISO proposes to use the maximum number of daily reserve activations in that same two-month period from the previous year at the 97th percentile. NYISO asserts that, as it previously stated in its March 24, 2008 filing, this approach is consistent with the manner in which credit requirements are determined for participants in NYISO's Virtual Transaction markets, and in the absence of substantial NYISO or general industry experience with Demand Side Resource Suppliers of ancillary services, NYISO believes

[9] Attachments K and W describe the manner in which the NYISO would estimate: (i) the intervals in which a Resource may incur a daily balancing obligation in either ancillary services market; (ii) the day-ahead market clearing price these suppliers would be paid; and (iii) the real-time market clearing price upon which their balancing obligations would settle. NYISO states that for purposes of estimating the day-ahead market clearing price and the real-time market clearing price, it used hourly, time-weighted [real-time] market clearing prices and measured the delta (i.e., difference) between these and the hourly day-ahead market clearing prices (*see* Transmittal at 6-7 n.11).

that this conservative approach is reasonable. NYISO states that in the future, as it gains more experience with Demand Side Resource Suppliers of ancillary services, the 97th percentile criterion may be reevaluated.[10]

15. NYISO states that its credit obligation for Demand Side Resources offering ancillary services is designed, as are all of its credit obligations, to protect the market against bad debt loss. NYISO views its worst-case approach for these credit requirements as reasonable, since that approach is based on empirical market data and the resource's own scheduled capacity. NYISO states that its proposed credit requirements for Demand Side Resources offering ancillary services are just, reasonable, and non-discriminatory, and asks the Commission to accept the additional justification provided above and approve the proposed credit requirements.

16. NYISO asks that these requirements be made effective as of May 24, 2008, the same effective date as requested in its earlier March 24, 2008 filing.

17. The only commenters, Multiple Intervenors, state that they support NYISO's credit requirements, and appreciate NYISO's attempt to finalize the opening of its ancillary services markets to Demand Side Resources by swiftly refiling support for the credit requirements in response to the May 23, 2008 Order. Multiple Intervenors point out that it has now been over four years since the Commission first encouraged NYISO to incorporate Demand Side Resources into its ancillary services markets, and that at this point, the only barrier to full participation by Demand Side Resources in the ancillary services markets is the Commission's approval of the credit requirements. Thus, Multiple Intervenors ask the Commission to expeditiously approve NYISO's compliance filing.

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[10] NYISO states that it also used the same approach for estimating the price differential between the respective day-ahead market clearing prices for either service and the real-time market clearing prices upon which balancing obligations would be settled. It states that it looked at day-ahead market clearing prices and hourly, time-weighted real-time market clearing prices from the same two-month period of the previous year for intervals in which the hourly, time-weighted real-time clearing prices exceeded the respective hourly day-ahead clearing prices and used the price differentials that appeared at the 97th percentile.

2. **Commission ruling**

18. The Commission grants waiver of the 60-day prior notice requirement[11] and accepts NYISO's June 9, 2008 tariff filing to be effective May 24, 2008, as proposed. We find that NYISO has demonstrated that its proposed credit requirements for Demand Side Resource participation constitute an appropriate balance between enabling Demand Side Resources to participate fully and freely in NYISO's ancillary services markets, and protecting NYISO's customers from the risk of default (the costs of which would be spread market-wide). We further note that NYISO has indicated that, as it gains more experience with integrating Demand Side Resources into these markets, it is likely to re-evaluate the current credit requirements, and we encourage NYISO to engage in such re-evaluation as appropriate.

The Commission orders:

(A) The Commission hereby grants the clarification requested by NYISO, as discussed above.

(B) The Commission hereby accepts NYISO's June 9, 2008 tariff filing, effective May 24, 2008.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[11] *See Central Hudson Gas and Electric Corp*., 60 FERC ¶ 61,106, *reh'g denied*, 61 FERC ¶ 61,089 (1992) (Commission grants waiver of the Federal Power Act requirement that a utility provide at least 60 days' prior notice of a rate change when that change has no rate impact or decreases a rate). Here, we anticipate that permitting additional entrants such as Demand Side Resources to participate in NYISO's ancillary services markets are likely to lead to lower costs for ancillary services for NYISO's customers.